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Rob Dower

Comments from the Chief Operating Officer

In a 2008 global survey of trust run by Edelman, a consultancy, US and UK respondents rated banks at 70% and 46% respectively in answer to the question 'How much do you trust banks to do what is right?'. This put banks among the most trusted of industries in those two countries – well ahead of their governments. In a repeat of the same survey, which was conducted this year but before August, the number was 25% for the US and 16% for the UK. No doubt the numbers will have dropped further after the latest quarter's uncertainty.

Economies and markets need trust to operate efficiently. Trust is built on the combination of institutions who are worthy of trust and individuals who are trusting. The two can work together in a virtuous circle, or just as easily in a destructive cycle. For distressed borrowers this effect is geared: a lack of confidence increases funding costs, which reduces their ability to repay. Thus, the current crisis in Europe, and indeed in developed markets, generally has caused a parallel crisis of trust. In his article Sandy McGregor looks at the complicated European context and discusses the few ways a country mired in debt can extract itself from its predicament.

Investment views

The investment management industry has a challenging chain of trust that runs from you, the investor, potentially through pension fund trustees, investment managers, custodians and the managers and employees of listed companies in which we invest your funds. There is the potential for failures of competence and ethics at each of these layers, and yet we are bound to trust each other down the chain to make investments efficiently.

We take our role in this chain seriously and we regard your trust and confidence in us as one of our critical strategic assets – as important as our skill in investing. With the current enormous financial uncertainty, people looking for reassurance and advice can easily be confused by the many sources of commentary, and this can reduce trust and drive destructive investor behaviour. We will generally not comment on short-term market moves, even if they are dramatic. Rather, we invest time and effort in adding to our clients' ability to understand investment issues through this publication and through the media.

We think it is appropriate to invest in companies that our research indicates have meaningful pricing power. This makes more sense to us than trying to predict just how high profits may go in the current high-profit environment, especially as profits usually return to historic averages. In his article Simon Raubenheimer discusses some of the reasons why we don't think current profit levels are sustainable.

One of the threats to current company profitability in South Africa is that consumers are heavily indebted. Part of this debt is flowing from the microlending industry. Alarmingly, microloans are growing at a rate of 44% per year. Jacques Plaut researches a few of the most well-known microlending crises, and concludes that the current high rate of growth in South Africa is a sign for investors to be cautious.

In the June issue we discussed the revised retirement fund regulations in some detail. With these regulations in mind, some investors have begun to question whether or not a retirement annuity fund is still a suitable product choice. Christo Terblanche and Wanita Isaacs compare saving for retirement via the Allan Gray Retirement Annuity Fund to saving with a discretionary unit trust investment.

Time flies

You may have seen our new advertisement which uses a fairytale-like story to subtly reinforce the importance of time in the journey of creating wealth. We often speak about the importance of taking a long-term approach to your investments, and once again, we encourage you to stay the course.

Thank you for your trust, we don't take it lightly.

Kind regards

Rob Dower

Sandy McGregor

The August crisis

EXECUTIVE SUMMARY: Trust in governments worldwide has been badly eroded over the last three years thanks to ongoing financial crises. This has come to a head again in the last few months, with governments appearing to be increasingly powerless in the face of excessive debt, which is spooking the markets. The simple fact is that debt levels are unsustainably high and there is no clear indication how countries are going to be able to get themselves out of this hole. According to Sandy McGregor, the complex interaction of politics and economics makes it very difficult to predict outcomes.

The British press calls August the 'silly season' on the grounds that, with everyone on holiday, nothing important happens, which forces newspapers to fill their pages with trivia. Of course, this can be regarded as a parochial northern hemisphere attitude and some of the most momentous events in history, such as the start of World War One, have occurred in August. In the financial markets 2011 has also proved to be an exception to this rule, although some cynics would argue that the political shenanigans we have recently witnessed are absolutely in accord with the concept of a silly season.

In the first week of August, equity prices worldwide sold off steeply, with the MSCI World Index falling from 1 342 on 26 July to 1 130 on 10 August, reflecting concerns about the stability of the world financial system. There was a further bout of selling during the last week in September. This has prompted a plethora of comment and explanations, which makes one nervous to add to the enormous amount written on this subject. However, as investors, it is important we see clearly through all the market noise and identify the fundamental causes of recent events.

> "The simple fact is that debt levels are unsustainably high..."

The problem: too much debt

Underlying this financial turbulence is an increasingly widespread recognition that much of Europe and the United States is burdened with excessive debt, and in particular unsustainably large sovereign debt. When the financial crisis of 2008 struck with unprecedented ferocity, governments responded with massive increases in expenditure at a time when their tax revenues were rapidly declining. For some countries such as Ireland, Spain and the United Kingdom bailing out their banking systems has converted a banking crisis into a fiscal crisis. In the United States, Spain and Ireland, amongst others, property bubbles with an accompanying unsustainable rise in household debt, have aggravated the deteriorating fiscal position.

In 2009 two American economists, Carmen Reinhart and Kenneth Rogoff, published their book 'This time is different', a study of financial crises from 1200 onwards. In this well-timed contribution to financial history, they identified that once public debt reaches a level 3.5 times greater than fiscal revenues, or becomes greater than 90% of GDP, a financial crisis is probable. History suggests this is the tipping point beyond which public finances implode. As can be seen in **Tables 1** and **2**, many countries, including the United States, are dangerously close to this tipping point and Ireland and Greece are clearly beyond it. A combination of an overleveraged government and excessive private debt is particularly dangerous.

How to escape a debt trap

There are various ways a country mired in excessive debt can extract itself from its predicament:

- A growth in the nominal value of economic activity can boost incomes and tax collections to make the debt burden sustainable. This is the favoured solution and can be achieved either through real growth, or inflation, or both.

- Living standards can be reduced to boost savings, and welfare payments by government can be curtailed to create a fiscal surplus. Together these steps allow public and private debts to be reduced to a sustainable level. Such a solution is a political anathema and will be done only as a last resort and under extreme coercion.

- Borrowers can default on their obligations, making their creditors share in the general misery. Default can be explicit or implicit, for example through inflation, which is a tax on creditors.

The highly indebted nations are struggling with these choices. Unfortunately the growth option is largely precluded by the deflationary pressures described below, and they are desperately trying to avoid opting for either default or reducing living standards.

TABLE 1 | Ratio of government debt to GDP (%)

31 December	2007	2010
United States	64.8	95.1
Euro Area:		
Germany	65.0	83.6
France	70.5	89.1
Ireland	28.1	99.2
Greece	108.8	149.3
Italy	107.3	123.0
Spain	41.3	54.5
Portugal	71.4	97.4
UK	46.8	78.8

Source: I-Net Bridge, IMF

TABLE 2 | Ratio of government debt to fiscal revenues

31 December	2007	2010
United States	3.44	5.84
Euro Area:		
Germany	1.49	1.92
France	1.42	1.79
Ireland	0.76	4.78
Greece	2.72	3.82
Italy	2.32	2.67
Spain	1.01	1.87
Portugal	1.73	2.35
UK	1.37	1.94

Source: I-Net Bridge, IMF

The consequences of adverse demographics

The intractability of the current crisis is exacerbated because the mature developed economies also face major demographic problems. The post-war 'baby boom' generation (born between 1945 and 1960) has provided inadequately for its retirement, partly because it believed growing economies would deliver prosperity in perpetuity, and also because it trusted the promises of governments regarding pensions. The lack of adequate pension funding has been aggravated by increasing longevity.

Events of the past three years have been a major wake-up call. Suddenly there is a much greater awareness that individuals have to assume responsibility for their own futures. Trust in governments has been badly eroded. People are cutting back on expenditures and saving more.

Governments become impotent

This fundamental change in individual behaviour, together with a cautious attitude to debt and investment in the business sector, is increasingly rendering ineffective the traditional policy prescriptions used to manage economies. The conventional response to an economic slowdown has been to cut interest rates and increase government spending. Theoretically this should result in nominal growth and a reduction in the burden of debt, as described in the first option above. But in a world where a substantial majority of households wishes to reduce borrowing, cutting interest rates has little effect. People will not increase their borrowing at any price. Indeed, low interest rates have a pernicious unintended consequence of reducing the income of savers. To reach their targeted level of savings, households have to cut back even further on spending.

The US Federal Reserve (the Fed) has responded to the failure of conventional monetary policy by implementing unconventional measures, following a path pioneered by Japan. Dollar interest rates have been cut almost to zero, and between November 2010 and June 2011 the Fed effectively printed money to fund US$600 billion of government debt. Although the Fed bravely claims that this programme of quantitative easing has had a positive impact, in practice it has proved to be impotent in dealing with deflationary forces caused by rising savings. The US experience follows a similar failure in Japan.

The alternative of fiscal stimulus has also run out of road because in many countries government debt has reached

levels which are unsustainable. Governments entered the 2008 crisis assuming that there was no limit to how much they could borrow. Increasingly this is proving not to be the case. As debt rises, the cost of servicing it becomes more onerous, crowding out other expenditures. Also, the multiplier effect of government spending on the economy declines when the primary focus of households is to strengthen their balance sheets. In these circumstances a large proportion of any rise in personal incomes generated by government spending is saved rather than spent.

The euro crisis

Increasing focus on the creditworthiness of sovereign governments has brought to the fore a particular problem facing the members of the eurozone. Countries such as the United States or Japan may be highly indebted, but they are sovereign issuers that can, in the last resort, repay debt by printing money. In the euro area governments have surrendered that power to the European Central Bank which, in terms of the Maastricht Treaty, is prohibited from monetising government debt. The options available to the member states to eliminate excess borrowing are limited to fiscal restraint or default. Given the unpopularity of harsh fiscal measures and their secondary effect on state revenues the probability of some form of default, at least in the case of Greece, is very high.

It is ironic that the market accords a higher rating to sovereign issuers that can debase their currencies over those that cannot, probably because the fiscal oppression through money printing and inflation takes longer than a sudden default to exact its toll. As risk of default rises, investors are demanding higher interest rates from the highly indebted states of southern Europe. If these rates were to become the norm over the longer term, the cost of borrowing would ultimately become unsustainable. Europe faces a dilemma that seems to have no simple solution. The concept of pooling all member countries' credit is unacceptable to the taxpayers of northern Europe, as this would involve a permanent and continuous transfer of resources from the north to the south. It would also involve transferring political powers to institutions in Brussels, which suffer from a serious democratic deficit. If there is to be no financial union, the countries to the south either have to cut government spending massively or default. The intractability of these problems is spooking the markets.

Political pressures are pushing countries such as Ireland and Greece, most of whose debt is owned by foreigners, to opt for default. It is noteworthy that Iceland's economy has started to recover since it defaulted on debts owed by its banks to the UK and the Netherlands. In Italy, on the other hand, the majority of public debt is owned by Italians, therefore the option of default is far less appealing.

Whatever the outcome in Europe, one thing is certain: governments will have to reduce their deficits. In effect they will have to save more, adding to the deflationary pressures caused by increased household saving.

The increasing powerlessness of governments is spooking the markets

The August crisis can be attributed to investors realising that one of the concepts they have accepted all their lives may not be true. Up to now it has been widely believed that governments have the power to intervene successfully in an economic crisis. For the current generation of investors, the concept that governments are in fact powerless to counteract the adverse effects of excessive debt, is something very new. There is a precedent to support this view in Japan, which for 20 years has tried and failed to escape from deflationary stagnation. The complex interaction of politics and economics makes it very difficult to predict how events will develop, but the outcome will be largely determined by the simple fact that debt levels are unsustainably high.

Sandy joined Allan Gray in October 1991. His current responsibilities include the management of fixed interest and individual client portfolios. Previously he was employed by Gold Fields of South Africa Limited for 22 years, where much of his experience was focused on investment-related activities.

Simon Raubenheimer

An era of high global earnings

EXECUTIVE SUMMARY: Company profits are currently at historic highs, but we do not know with any certainty where they are headed. Although it is entirely possible for global and South African profit levels to remain elevated for quite some time, the unfortunate reality is that profits usually return to historic averages. To bet on profits remaining high into perpetuity would be to disregard the 50 years of earnings history we have on South African businesses. Simon Raubenheimer discusses.

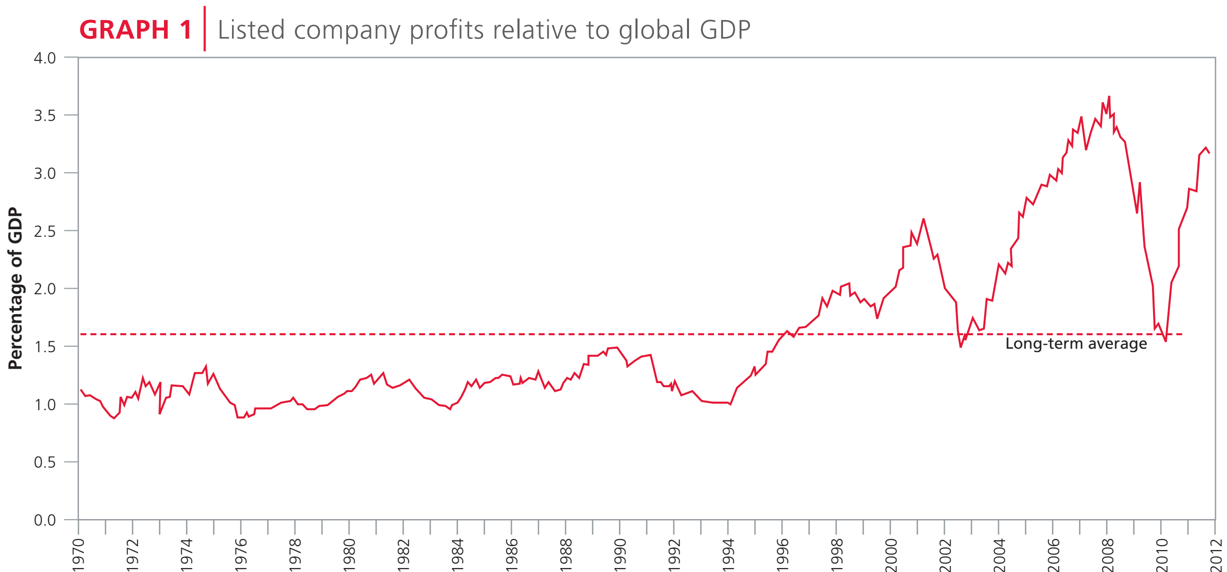
One of the most noteworthy features of financial markets today, is the extraordinary level of profitability enjoyed by many companies around the world. This is in stark contrast to the continuous bad economic news we are barraged with on a daily basis. Yet high company profits are a reality for both developed and emerging countries. Profits in aggregate are consuming a near record portion of global GDP (see **Graph 1**). Operating profit margins for the S&P 500, excluding the volatile financial services and energy companies, are at their highest levels in at least 50 years (see **Graph 2** on page 6).

There are numerous reasons why global profitability has grown so much. Companies in many developed countries have benefited from falling effective personal and corporate tax rates, which have boosted earnings. An unpredictable and subdued economic climate has resulted in companies, particularly in Europe and the US, being cautious with their retained capital, using it to pay off debt rather than committing to significant capital investments. Combined with falling interest rates, this has led to lower interest costs. Furthermore, with real unit labour costs in the US now at 60-year lows, profits have grown to a large extent at the expense of wages in the developed world.

South African company profits are acutely high

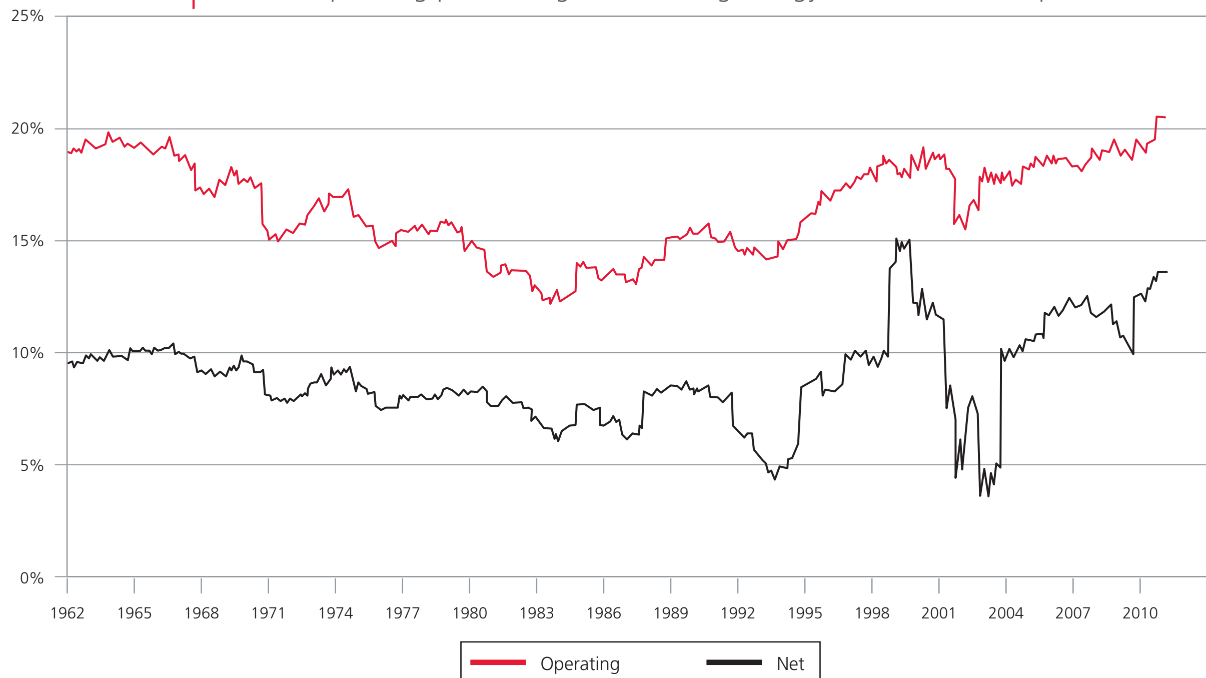
Graph 3, on page 7, shows real earnings, or profits, of South African listed companies using the FTSE/JSE All Share Index (ALSI) over the past 52 years.

GRAPH 1 | Listed company profits relative to global GDP



Source: MSCI, OECD, IMF, Morgan Stanley research

GRAPH 2 | S&P 500 operating profit margins, excluding energy and financial companies



Source: Orbis research

The following observations are immediately apparent:

- **Profits grow in real terms, in other words, by more than inflation:** Over the past 52 years, earnings for listed companies in South Africa in aggregate have grown by 3.3% above inflation.

- **Profits are cyclical:** As our offshore partner, Orbis, noted in a recent Quarterly Report: 'Profit margins rise and fall with the ebb and flow of competition and economic cycles.' To determine a normalised level of earnings, we have fitted a trend line to Graph 3. Historically, profits above this trend line have proved to be unsustainable and always come back down to meet the trend line, and vice versa.

Our concern is that current reported profits are 45% above the long-term trend line. Earnings have only been higher than they are today 9% of the time, relative to the trend line. A similar picture emerges when we compare current profits to the average of the trailing 10-year inflation-adjusted profits (see **Graph 4**).

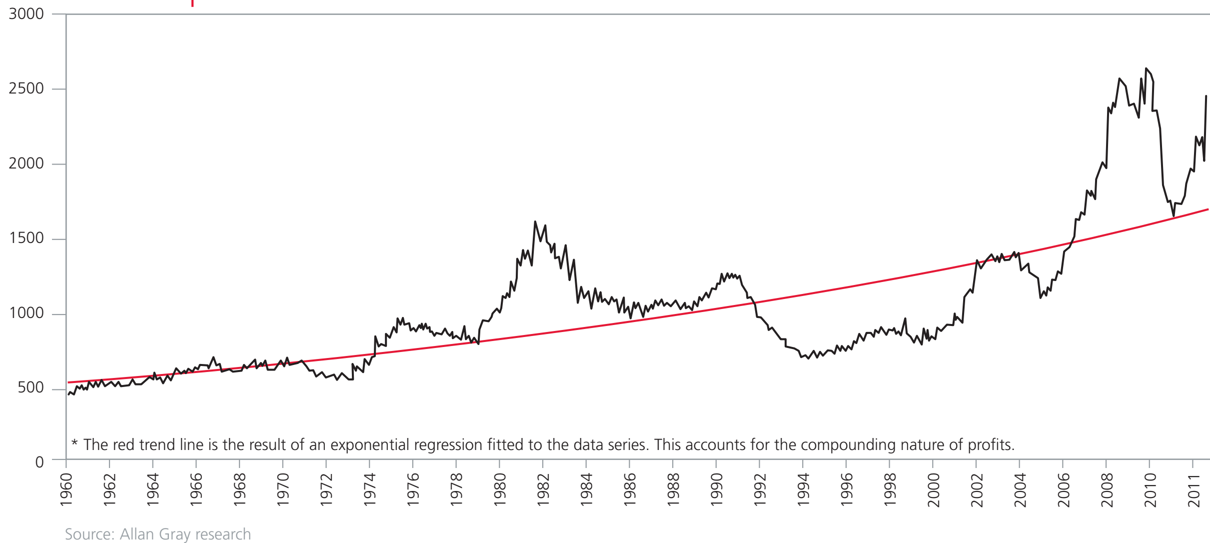
On this basis, profits are 37% above the 10-year rolling average.

There are a number of explanations as to why South African listed companies are currently so profitable. Two important reasons are:

1. Over the past 10 to 15 years, an environment of falling inflation rates, falling interest rates and strong domestic asset prices (both stock markets and real estate) has provided a near-perfect backdrop for consumer expenditure. Net household debt to disposable income in South Africa has grown from just over 50% to almost 80% over the past decade. For many years, consumer credit extension grew by over 20% per annum. Real wage growth in South Africa, particularly in the public sector, has been strong. This has benefited numerous domestic retail and financial consumer businesses.

2. With resource companies accounting for almost 40% of the ALSI, the rise in commodity prices over the past decade has had tremendous impact on aggregate ALSI profits. For example, a basket of commodities consisting of copper, iron ore, oil, metallurgical coal, zinc, aluminium and nickel, as produced by BHP Billiton, has risen almost fivefold in real terms since the early 2000s. This has enabled BHP's profits to grow tenfold over the same period.

GRAPH 3 | ALSI real earnings vs trend line



Source: Allan Gray research

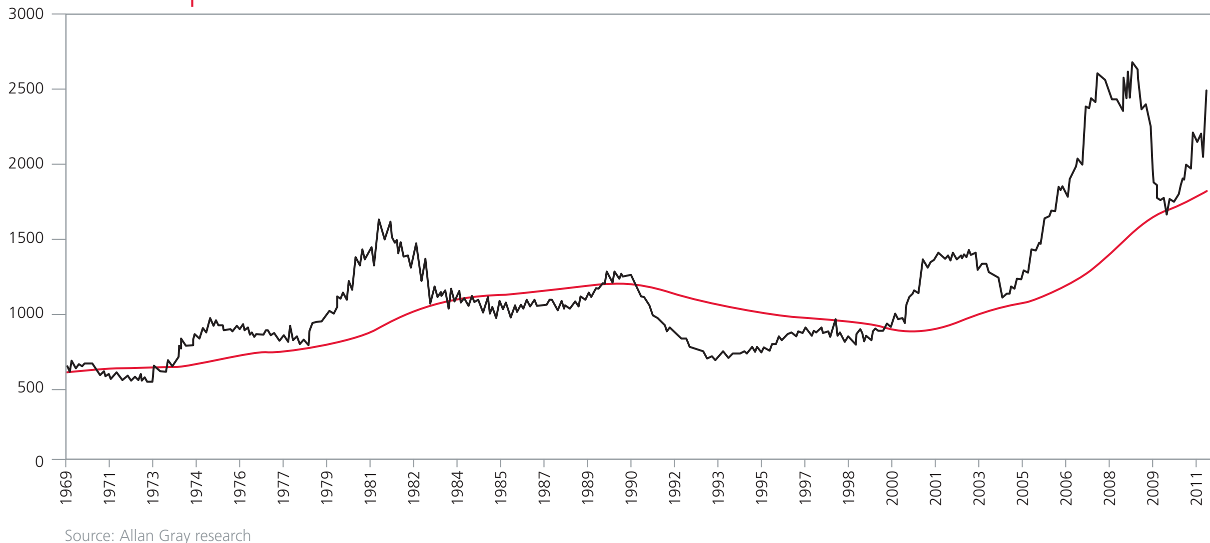
Where to from here for profits?

While we can assert that profits are high in an historical context, we do not know with any certainty where they are headed. It is entirely possible for global and South African profit levels to remain elevated for quite some time. However, there are various threats worth bearing in mind:

Consumers are heavily indebted. Debt servicing costs to disposable income are not low, despite the record low interest rates. The introduction of the National Credit Act in 2007 has become, and will continue to be, a much warranted headwind for consumer activity. Asset prices – both the stock market and house prices – are not rising at the rates they were for the past decade, and bank lending has slowed.

Meanwhile, at current commodity prices, the returns on capital generated by the global miners are very high. The potential supply of certain commodities such as iron ore (30% of Anglo American and 40% of BHP Billiton profits),

GRAPH 4 | ALSI real earnings vs 10-year rolling average



Source: Allan Gray research

manganese or thermal coal is virtually unconstrained over the long term. With the only barrier being the capital required to build mines and surrounding infrastructure, it is only a matter of time before the supply will rise to meet the projected demand. As we highlighted in our previous issue of Quarterly Commentary (Q2 2011), the combined capital expenditure of four big global miners, namely BHP Billiton, Anglo American, Vale and Rio Tinto, is likely to exceed US$50 billion next year. Adjusted for inflation, this is more than 10 times what they spent in 2000. Paradoxically, the best cure for high commodity prices may be high commodity prices.

The basic mechanisms of market economics mean that profits are mean reverting. Higher profitability begets competition, which drives down returns, and so the cycle continues. To bet on profits remaining high into perpetuity would be to disregard the 50 years of earnings history we have on South African businesses.

"To bet on profits remaining high into perpetuity would be to disregard the 50 years of earnings history we have on South African businesses."

We continue to follow our investment philosophy

As always, we think it is appropriate to invest in companies that have meaningful pricing power and are able to maintain their profitability in an environment where profits may be pressurised. Unsurprisingly, this characterises many companies in our top 10.

The market as a whole is currently selling for 12.5 times trailing profits. This price to earnings multiple is not far from the 50-year average multiple of 11.9 times, therefore current company valuations appear reasonable at first glance. However, the risk is that the current high level of company profits proves unsustainable and that company profit levels head back to historic norms and act as a significant drag on expected returns from our equity market.

Simon is an equity portfolio manager. He is a CFA charter holder and has been with Allan Gray since 2002.

Jacques Plaut

Money for everyone

EXECUTIVE SUMMARY: Microlending has a history that can be traced back to 3 000 BC. Throughout this period people have shown a tendency to become over-indebted, and when this happens on a large scale it is often ruinous for lenders. In South Africa, microloans are growing at a rate of 44% per year, and many listed companies are expanding their activities in the sector. Jacques Plaut researches a few of the most well known microlending crises, and concludes that the current high rate of growth in South Africa is a sign for investors to be cautious.

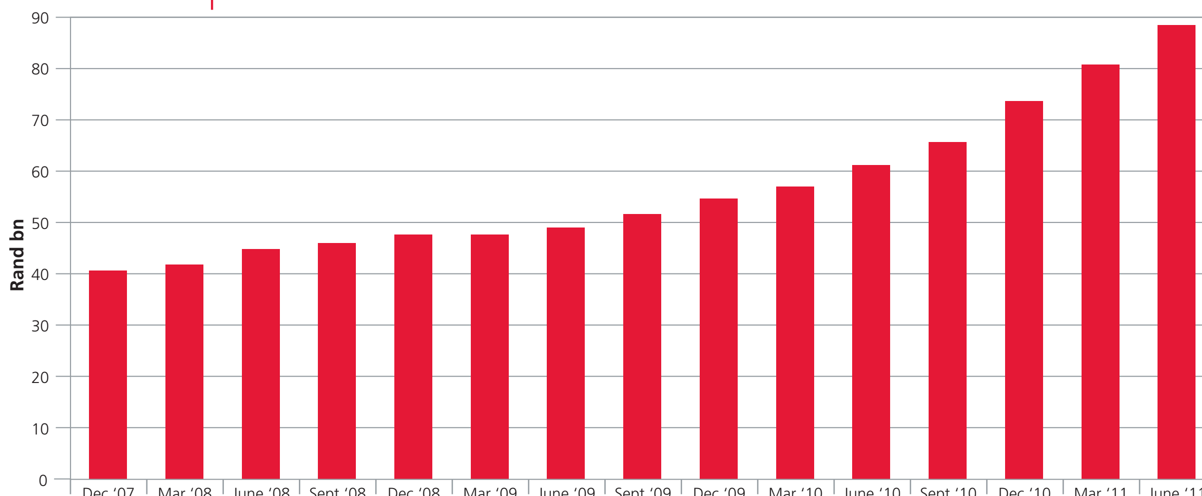
'You are one of the most contemptible usurers in your unspeakable business. Men of your type are a curse to the community, and the money they gain is blood money.' With these words Daniel Tolman was sentenced to prison in 1913, on a charge of lending US$10 at an annual interest rate of 200%. One wonders what the judge would have thought of the UN's Year of Microcredit 2005 ('microcredit has been changing people's lives and revitalising communities since the beginning of trade'), or of the 2006 Nobel Committee's decision to award its Peace Prize to Grameen Bank, a Bangladeshi microlender.

According to the National Credit Regulator, South Africans owe a collective R88 billion in the form of unsecured loans. To put this number into context, our annual gold exports are about R81 billion, the listed retail sector made R19 billion in profit last year, and GDP is R2.4 trillion. What is more striking than the absolute number is the rate at which it is growing: 44%, which means the amount of unsecured debt doubles every two years.

A very old profession

The history of microlending is colourful and sometimes tragic. There are records of loans made at 48% per month in classical Athens, of pawnbrokers in the middle ages charging 80% to 170% per year, and of payroll lenders in the US charging 20% per week. Mesopotamia, Greece, and Rome each had at least one debt crisis due to microloans: 'Farmers were sometimes able to keep only the sixth part of their produce. Personal slavery of whole families for debt was permitted and became common'[1]. There are plenty of examples closer to our own time, certainly not confined to poor nations:

GRAPH 1 | Gross unsecured debt



Sources: National Credit Regulator

[1] A History of Interest Rates, fourth edition, pg 34.

- Japan had nearly three million over-indebted consumers in 2006, and 14 000 registered money lenders. Today only 1 000 of the lenders are left, and the listed ones have lost two-thirds of their value. The high debt burden prompted regulators to impose an interest rate cap.

- The Indian state of Andhra Pradesh at first embraced microlending as a means to end poverty. However, the debt burden soon became unsustainably large and since October 2010 regulators have prevented microlenders from collecting their loans.

- Many readers will remember UniFer and South Africa's own microlending crisis in 2002. The government became concerned about the rising indebtedness of its own employees, and stopped the practice of allowing lenders to deduct interest payments directly from workers' salaries. UniFer was unable to collect its debt, and after trying to hide the problem by making even more loans, went bankrupt in a spectacular fashion.

In most of these cases the story is similar: people borrow more than they should, the debt burden becomes overwhelming, newspapers start reporting on aggressive collection practices and debt-related suicides, regulators change the rules, and finally most microlenders go out of business. Incidentally, for the purposes of this article I use the term microloan to mean any unsecured, high-interest loan. Placing non-profit development banks in the same category as medieval pawn shops is perhaps unfair, but at least in the South African context microlenders tend to be comparable businesses.

The regulators' dilemma

It is difficult to make a call on how microloans should be regulated. One camp argues for letting borrowers make their own financial decisions and for allowing lenders to charge what they want: high returns will attract competition, drive down prices, and give more people access to credit. Some even argue forcibly that microloans are the key to ending global poverty, by allowing entrepreneurs to access capital. But the whole weight of history speaks to people's tendency to borrow too much and the ensuing problems.

In reality, people use microloans to pay back previous debt and to finance consumption more often than they use them to start small businesses or for emergency car repairs. Most of the research that purports to show that microloans help the poor, only really shows that it is better to borrow at 50% from a microlender than at 250% from a loan shark.

The situation in South Africa

The law regulating microloans in South Africa is the National Credit Act. It has many sensible provisions: fees and interest rates have to be disclosed in a way that helps borrowers to do comparison shopping, and lenders may not extend 'reckless credit'. This means, for example, that if a customer does not take home enough money to feed himself after paying off all his loans (something that happened in South Africa's 2002 microlending crisis), the lender is at fault and a court may cancel the debt.

These provisions might not be enough to prevent South Africans from becoming over-indebted. Customers can lie about their current level of indebtedness when applying for a new loan, and so far borrowers do not seem to be shopping around for the best deal. The average new loan has grown to R17 000, which is hardly 'micro', and has a duration of more than three years. Certain lenders are even offering seven-year microloans. The pure microlenders are not the only ones benefiting from this. Earnings from personal loans contribute handsomely to profits at some of the clothing and furniture retailers, and of course all this money is eventually spent somewhere: another benefit for retailers.

Exercise caution

Fortunately, we do not have to make the call on regulating microloans; our job is to protect your investment. Some microlenders are very well run companies with astute managers, and may prove to be sound investments. Others have displayed questionable reporting and lending practices. As a whole, though, when unsecured debt is growing at 44% per year it is a sign to be cautious. Even seemingly unrelated sectors of the economy that are experiencing a temporary windfall could be more risky than they appear.

Jacques is part of the investment team. He joined Allan Gray in 2008 after working as a management consultant. Jacques completed his BSc degree at UCT, and has passed level three of the CFA exams.

Wanita Isaacs

Christo Terblanche

Do the more restrictive individual investment limits on RAs outweigh their tax benefits?

EXECUTIVE SUMMARY: Previously, retirement funds were considered an obvious choice for many investors due to the tax benefits they afforded. However, changes to Regulation 28 of the Pension Funds Act, which limit an individual's exposure to certain asset classes, have brought the choice of product into question for some investors. Christo Terblanche and Wanita Isaacs compare saving for retirement via the Allan Gray Retirement Annuity Fund to saving with a discretionary unit trust investment.

The tax benefits of investing in a retirement annuity fund (RA) have meant that to date they have been a popular choice for retirement savers. Many RAs, including the Allan Gray Retirement Annuity Fund, offered the additional benefit of investment flexibility, allowing individual investors to be fully invested in equities by applying investment limits only at the fund level. Some of our clients have expressed concern that the recently revised retirement fund investment regulations put them at a disadvantage as they cannot invest fully in equities (see the text box below). These investors could forego the tax benefits of RAs and avoid their restrictions by rather investing directly into unit trusts, also known as 'discretionary' investments, to try to maximise their long-term returns. This raises an important question: do the benefits of an RA outweigh the potential for higher returns from full exposure to equities? The answer to this question depends on your circumstances, most significantly your investment period and your marginal tax rate, as well as the long-term outlook for equities.

"...it is also important to remember that an RA ensures that your savings are kept for your retirement..."

The tax benefits of an RA outweigh the investment restrictions over all but the longest periods

A critical assumption we have made, is that an RA will not cost an additional layer of fees. This is true for the Allan Gray RA and for many others in the market, but is certainly not universally true. Under this assumption, and those shown in the text box on page 14, our analysis reveals that at all marginal tax rates and retirement income levels, the benefits of an RA are only significantly outweighed by a discretionary investment in the very long term, even if equities outperform significantly relative to other assets.

Table 1, on page 12, shows that over a 10-year period, in which equities outperform cash by just over 7% per year on average (as they have during the last 10 years), the tax benefits of an RA are not outweighed by a discretionary investment. On the other hand, if equities significantly outperform other assets over very long periods, compound growth on the excess returns that are possible from full equity exposure can make a discretionary investment more attractive.

During the first quarter of this year, the Minister of Finance introduced revised investment requirements for retirement funds (Regulation 28 of the Pension Funds Act). One of the key objectives of the regulation is to ensure retirement fund investments are adequately diversified and it aims to achieve this by prescribing the maximum exposure that members may have to certain asset classes (e.g. 75% in equities, 25% in property, 25% in foreign assets). Previously Regulation 28 only prescribed maximum limits at retirement fund level, meaning that members could potentially select asset class exposures of their choice outside these limits to make up their investment account, provided that the retirement fund's total holdings complied with the regulation across all of its members.

For more information on the amendments to Regulation 28 and the impact on investors, please refer to our article 'Making sense of the revised retirement fund regulations' in Quarterly Commentary 2, 2011.

TABLE 1 The additional benefit of investing in an RA (at 75% equity exposure) over a discretionary investment (at 100% equity exposure) over different periods

Investment period until retirement				10 years		40 years	
Scenarios of annualised performance of equities over cash				Low equity outperformance scenario	High equity outperformance scenario	Low equity outperformance scenario	High equity outperformance scenario
Contribution rate	R1 000	Marginal tax rate	25%	37%	22%	10%	-44%
	R2 500		35%	55%	33%	24%	-10%
	R5 000		40%	59%	37%	25%	-2%
	R10 000		40%	65%	53%	24%	-3%

Note: Cash is used to represent other assets in which an RA member may invest to comply with Regulation 28. The periods used to illustrate low equity returns relative to cash are the lowest 10- (-3.5%) and 40-year (3.6%) periods since 1960. The periods used to illustrate high equity returns relative to cash are the most recent 10- (7.2%) and 40-year (6.9%) periods during which equities significantly outperformed cash. The assumptions used in this analysis are shown in the text box on page 14. The investment benefit used to determine the difference in value is the after tax income received during a 20-year retirement period and any remaining balance received by beneficiaries as a death benefit. A negative value in the table indicates that an RA was found to be less beneficial than a discretionary investment.

Source: Allan Gray research

The higher your income tax rate, the more tax savings are possible in an RA. Assuming a contribution rate of 7% of income, the tax benefits of contributing to an RA increase with your contribution rate. Table 1 shows that a discretionary investment may be more beneficial than an RA at all contribution rates over a 40-year period in which equities outperform other assets by almost 7% per year. But as contributions increase, the benefit of the discretionary investment decreases significantly. For example, our analysis showed that over a shorter time period of 30 years at the same level of equity return, a discretionary investment would only be better for investors with low marginal tax rates (of 30% or less), who we have assumed would be contributing at rates of R1 500 per month or less.

It is important to think about the long-term outlook for equities when planning for retirement

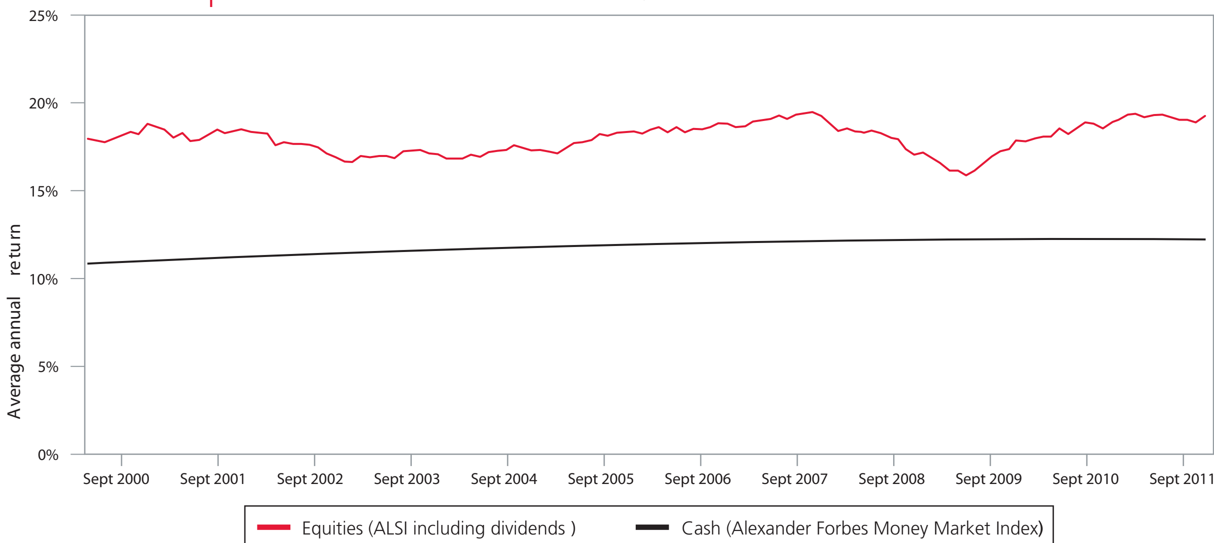
Graph 1 shows the average return per year for equities compared to cash for 40-year rolling periods ending at the dates shown on the horizontal axis, since 1960. The lowest long-term equity performance relative to cash occurred in the 40 years up to April 2009, when equities outperformed cash by just 3.6%. Over a similar return period, an investor at any of the contribution rates shown in Table 1 would be better off in an RA. Equities would need to outperform other assets by at least 5% over 40 years to make a discretionary investment better than an RA even for an investor at the lowest marginal tax rate in our analysis, which corresponds to a contribution of R1 000 per month.

Investor behaviour affects investment returns

As shown in Graph 1, historically, equities have consistently outperformed other assets over the very long term. On average, over periods of 10 years or longer, equities have delivered at least 6% more than cash per year. But the potential for higher returns comes at the cost of greater risk, in the form of short-term volatility and, therefore, the possibility of losing money by selling at the wrong times. For example, in the 10-year period to July 2004, equities delivered returns of 3.5% less than cash per year. If you are considering a discretionary investment for your retirement savings because you believe that the outlook for equities over the very long term is favourable, your ability to stay invested and to tolerate ups and downs in the market should play an important role in your decision.

Investors who may be comfortable with full equity exposure while equities are outperforming may become more risk averse during downturns in the market and may wish to switch to more conservative unit trusts. Switching involves selling units, which increases the impact of capital gains tax (CGT) in a discretionary investment. The possible advantage of a discretionary investment over long time horizons, as discussed above, is based on an investment strategy of buying into equity unit trusts and holding them for the duration of the investment. An investor willing to wait out the ups and downs can benefit in the long term, but must be comfortable with often dramatic volatility, including periods of underperformance that can last for many years.

When comparing RA and discretionary investments, it is also important to remember that an RA ensures that your savings are kept for your retirement, while a discretionary investment allows you to withdraw your money at any time. Investors saving for retirement in a discretionary investment might encounter significant life events such as job changes, buying a new home or starting a family, which could tempt them to withdraw some or all of their savings. Aside from



Source: I-Net Bridge

depleting their provision for retirement, early withdrawals could also reverse the potential long-term benefits of higher equity exposure by decreasing the effects of compound growth and increasing the impact of CGT on the investment. On the other hand, investors who are confident of their ability to meet their retirement needs may see less value in this withdrawal 'straitjacket'.

If you have a very long time horizon and therefore decide to invest directly into equity unit trusts, but you then withdraw your money after a 10-year period of equity underperformance relative to other assets, you can quite easily reverse the advantage your discretionary investment might have afforded, and end up being worse off than had you invested in an RA over the same time period.

An RA remains an effective investment product for most investors saving for retirement

Although compliance with Regulation 28 requires lower exposure to equities than some investors prefer, the tax efficiency of an RA, combined with the lower exposure to investment risk, makes it an effective way to save for retirement for most investors.

"For many long-term savers, the answer may be a combination of discretionary unit trust investments and investments in an RA product wrapper."

Investors with lots of time to save and who are confident that equities will significantly outperform other assets may do better with a discretionary investment. However, these investors need to have the discipline to leave their money invested and to stick to their investment strategy over the long term. It is important not to underestimate the temptation to withdraw; an RA offers the security of knowing your retirement savings will be kept for your retirement.

Our analysis required us to make assumptions that hide important differences between individual investors' circumstances. For many long-term savers, the answer may be a combination of discretionary unit trust investments and investments in an RA product wrapper. If you are uncertain as to what is most suitable for you we suggest you consider speaking to an independent financial adviser.

Assumptions

Investment strategy and returns

We assessed the effect of contributing towards your retirement over different investment periods, using different return scenarios. The return scenarios are based on actual historic equity and cash returns for rolling 10-, 20-, 30- and 40-year periods since 1960. Within the discretionary investment we assumed a consistent investment strategy of full equity exposure for the whole investment period, including retirement. In the RA we assumed 75% exposure to equities pre-retirement (the maximum allowed in terms of Regulation 28) and full equity exposure on transfer to a living annuity at retirement.

Contribution levels

When you invest directly into unit trusts, you use money that has been taxed at your marginal income tax rate. In comparison, you do not pay tax on your contributions to an RA. Currently up to 15% of the portion of your income not used to calculate contributions to an employer's retirement fund is tax deductible. At higher tax rates you are able to contribute more to an RA than to a discretionary investment. Assuming contributions at 7% of salary, we tested different pre-retirement contribution rates, and for each RA contribution example the income tax tables were applied so that the corresponding discretionary contribution is lower. The contribution rate examples shown in Table 1 assume contributions escalated at 10% per year.

Withdrawals and estate planning

Within an RA you are not taxed on either interest or capital gains and at retirement from an RA you are entitled to take up to one-third of your investment as a cash lump sum, the first R315 000 of which is currently tax free. The rest of your investment must be transferred to a pension-providing vehicle such as a living annuity. For the purposes of this investigation, we assumed the maximum tax-free amount was taken at retirement and we took future income tax into account on the income drawn during retirement.

In a discretionary investment you are subject to capital gains tax (CGT) whenever you sell units. We assumed no switching between unit trusts and no withdrawals before retirement. During retirement, for each living annuity income level we assumed the same amount drawn from the discretionary investment as gross income. We calculated CGT on this amount, assuming that the investment is the only source of income and taxable capital gain during retirement.

At the end of the assumed 20-year retirement period the balance remaining in both the discretionary investment and the RA was treated as a cash withdrawal for the benefit of beneficiaries.

Although Regulation 28 also limits an investor's exposure to foreign investments, in this investigation we assumed only local investments.

Wanita is a business analyst in the product development team. She is a UCT graduate and has been with Allan Gray since 2008.

Christo joined Allan Gray in 2000. He is currently jointly responsible for the retail business, heading up the product development, legal and compliance teams in that division. Until March 2011 he assumed responsibility for the pooled institutional business, as well as overseeing the affairs of Allan Gray Life.

Henk Pieterse

Time flies

EXECUTIVE SUMMARY: The first half of our lives we spend wishing time would hurry up – life simply moves too slowly. The second half, however, we wish time would slow down; every second counts. This is the simple insight of our new television advertisement, which uses a fairytale to illustrate a wisdom of life, while subtly reinforcing the importance of time in the journey of creating wealth.

The story

The advertisement is set over a 35- to 40-year period, roughly 1960 to 2000, somewhere in South Africa. This is the story of an ordinary girl, from a middle-class family. As the girl grows older she does well. She studies hard and gets a good job. She marries and moves into a comfortable suburban home. She has a baby girl who is the apple of her eye.

Early on in the story we see the human truth of the impatience of youth. Our little girl is told that her birthday is only five days away. Wishing that 'time would fly' she discovers a way of travelling through time to the point in her life at which she wants to be. The girl uses her technique often in her young life to hurry time along. She time travels when she is not tall enough for a fairground ride, when she cannot wait to get married, and when she cannot bear to endure nine long months of pregnancy.

> "... time can work its magic for those who allow it, and who are focused on the long term."

Techniques

The teams at our advertising agency, KingJames, and production company, Velocity, spent a lot of time researching different reference actions and filming techniques to allude to passing through time. But we needed to make this particular time-lapse our own – ultimately deciding on a nose squeeze. By blowing her nose the girl creates an energy field that builds up to an enormous crescendo that 'pops' her forward in time.

Great care is taken each time a 'new' girl is introduced. The girl's position is matched using markers and video overlay is used to match the shots during the transformation. Background changes are minimal and subtle. The main character is played by different people in real life at different ages; facial features were painstakingly matched during casting, with special make-up used to enhance the appearance of the same person growing older.

The 'ah-ha' moment

In the final scene we recognise our lead as the child who has now become an adult. Across the room, standing in front of a mirror, is a beautiful little girl playing dress up. Our heroine watches her lovingly, savouring the moment.

There is a change in mood as it becomes apparent that the little girl has had enough of pretending – she too would like to be grown up... Mom is watching as her daughter tries to hold her nose and blow into the future. Our heroine has grown wiser with age. Her more mature perspective has lead to a deeper understanding that time passes quickly. She realises what her daughter is trying to do and holds her back. Instead of the desire to speed time along, she is desperate to hold on to these precious mother-and-daughter moments.

Wanting to be older and speed time away is an emotional phenomenon we all experience when we are growing up; then comes the turning point. We hope this 'ah-ha' moment resonates with viewers.

Time is valuable, make it count

In advertising, as in other forms of storytelling, one has the luxury of suspending belief. We are using this short fairytale-like story to illustrate a truth about life. Our advertisement aims to evoke an emotional response and an appreciation for the swift passage of time. Within

this emotional treatment is a subtle call to action: you do not realise how quickly time passes, so do not put things off for too long. There are no short cuts in life, but time can work its magic for those who allow it, and who are focused on the long term.

We try to use advertising to deepen understanding, not just to build awareness of Allan Gray. The new advertisement is an extension of the theme of illustrating the benefits of time, which we began in 2008. Similar to our other advertisements over the last few years, it takes the approach of not only focusing on Allan Gray, but on the investor as an integral part of our investment philosophy. As the investor, you have no control over the speed at which time passes, you cannot jump years like our protagonist, or push them back as she may have wanted to do. But you can decide today to make a long-term decision that will influence your future.

'Time Flies' was conceptualised by KingJames, produced by Velocity for Allan Gray and post-produced by Deliverance and Searle Street.

KingJames: Executive Creative Director: Alistair King
Head of Art: Karin Barry-McCormack
Head of Copy: Paige Nick
Agency TV Producer: Caz Friedman

Velocity: Director: Keith Rose
Producer: Grant Davies

Deliverance: Editor: Ricky Boyd

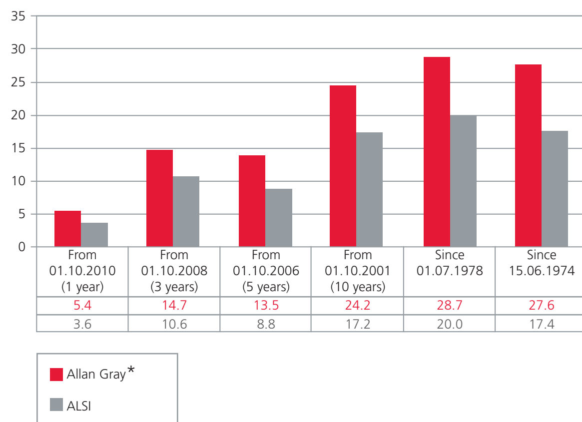
Searle Street: Flame Artist
and on-set VFX Supervisor: Udesh Chetty
IQ Artist: Charmaine Greyling
Colourist: David Grant
Facility Producer: Firoza Rahim
Creative Creator: Heino Henning

Henk joined Allan Gray in 2008 and heads up marketing. After qualifying as a CA (SA) he entered the financial services industry and has worked in areas of strategy, marketing, client service, finance, operations and information technology.

Investment track record - share returns

Allan Gray Proprietary Limited global mandate share returns			
	vs. FTSE/JSE All Share Index		
Period	Allan Gray*	FTSE/JSE All Share Index	Out/ underperformance
1974 (from 15.06)	-0.8	-0.8	0.0
1975	23.7	-18.9	42.6
1976	2.7	-10.9	13.6
1977	38.2	20.6	17.6
1978	36.9	37.2	-0.3
1979	86.9	94.4	-7.5
1980	53.7	40.9	12.8
1981	23.2	0.8	22.4
1982	34.0	38.4	-4.4
1983	41.0	14.4	26.6
1984	10.9	9.4	1.5
1985	59.2	42.0	17.2
1986	59.5	55.9	3.6
1987	9.1	-4.3	13.4
1988	36.2	14.8	21.4
1989	58.1	55.7	2.4
1990	4.5	-5.1	9.6
1991	30.0	31.1	-1.1
1992	-13.0	-2.0	-11.0
1993	57.5	54.7	2.8
1994	40.8	22.7	18.1
1995	16.2	8.8	7.4
1996	18.1	9.4	8.7
1997	-17.4	-4.5	-12.9
1998	1.5	-10.0	11.5
1999	122.4	61.4	61.0
2000	13.2	0.0	13.2
2001	38.1	29.3	8.8
2002	25.6	-8.1	33.7
2003	29.4	16.1	13.3
2004	31.8	25.4	6.4
2005	56.5	47.3	9.2
2006	49.7	41.2	8.5
2007	17.6	19.2	-1.6
2008	-12.6	-23.2	10.6
2009	28.8	32.1	-3.3
2010	20.9	19.0	1.9
2011 (to 30.09)	-1.4	-5.4	4.0

Returns annualised to 30.09.2011



* Allan Gray commenced managing pension funds on 1 January 1978. The returns prior to 1 January 1978 are of individuals managed by Allan Gray, and these returns exclude income.

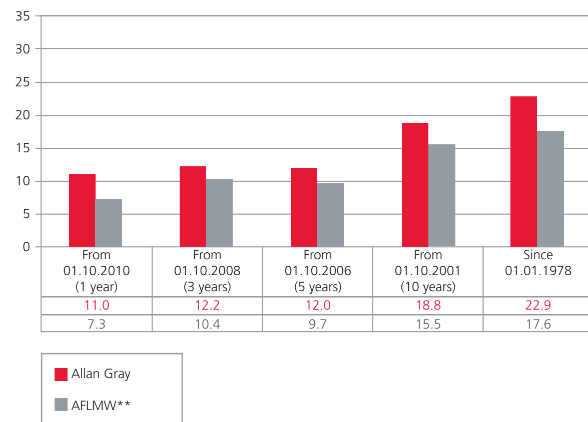
Note: Listed property included from 1 July 2002.

An investment of R10 000 made with Allan Gray on 15 June 1974 would have grown, before the impact of fees, to **R87 749 396** by 30 September 2011. By comparison, the returns generated by the FTSE/JSE All Share Index over the same period would have grown a similar investment to **R4 021 288**.

Investment track record - balanced returns

Allan Gray Proprietary Limited global mandate total returns			
	vs. Alexander Forbes Large Manager Watch		
Period	Allan Gray*	AFLMW**	Out/ underperformance
1974	-	-	-
1975	-	-	-
1976	-	-	-
1977	-	-	-
1978	34.5	28.0	6.5
1979	40.4	35.7	4.7
1980	36.2	15.4	20.8
1981	15.7	9.5	6.2
1982	25.3	26.2	-0.9
1983	24.1	10.6	13.5
1984	9.9	6.3	3.6
1985	38.2	28.4	9.8
1986	40.3	39.9	0.4
1987	11.9	6.6	5.3
1988	22.7	19.4	3.3
1989	39.2	38.2	1.0
1990	11.6	8.0	3.6
1991	22.8	28.3	-5.5
1992	1.2	7.6	-6.4
1993	41.9	34.3	7.6
1994	27.5	18.8	8.7
1995	18.2	16.9	1.3
1996	13.5	10.3	3.2
1997	-1.8	9.5	-11.3
1998	6.9	-1.0	7.9
1999	80.0	46.8	33.1
2000	21.7	7.6	14.1
2001	44.0	23.5	20.5
2002	13.4	-3.6	17.1
2003	21.5	17.8	3.7
2004	21.8	28.1	-6.3
2005	40.0	31.9	8.1
2006	35.6	31.7	3.9
2007	14.5	15.1	-0.6
2008	-1.1	-12.3	11.2
2009	15.6	20.3	-4.7
2010	11.7	14.5	-2.8
2011 (to 30.09)	7.3	2.7	4.6

Returns annualised to 30.09.2011



** Consulting Actuaries Survey returns used up to December 1997.

The return from 1 April 2010 is the average of the non-investable Alexander Forbes Large Manager Watch. The return for September 2011 is an estimate.

An investment of R10 000 made with Allan Gray on 1 January 1978 would have grown, before the impact of fees, to **R10 510 813** by 30 September 2011. The average total performance of global mandates of Large Managers over the same period would have grown a similar investment to **R2 405 560**.

Allan Gray Balanced and Stable Fund asset allocation as at 30 September 2011

	Balanced Fund % of portfolio			Stable Fund % of portfolio		
	Total	SA	Foreign[1]	Total	SA	Foreign[1]
Net equities	57.4	41.3	16.1	19.9	6.7	13.2
Hedged SA equities	10.9	3.0	7.9	24.3	14.3	10.0
Property	0.4	0.4	-	0.2	0.2	-
Commodities (new gold)	3.3	3.3	-	3.3	3.3	-
Bonds	10.2	10.2	-	9.7	9.7	-
Money market and bank deposits	17.8	15.4	2.4	42.6	39.8	2.8
Total	**100.0**	**73.6**	**26.4**	**100.0**	**74.0**	**26.0**

NOTE: There might be slight discrepancies in the totals due to rounding.
[1] The Fund is above its foreign exposure limit due to market value movements.

Allan Gray Equity Fund net assets as at 30 September 2011

Security (ranked by sector)	Market value (R million)	% of fund	JSE ALSI weight (%)
Resources	**7 271**	**28.3**	**36.8**
Sasol	2 634	10.3	
Anglogold Ashanti	1 190	4.6	
Anglo American*	819	3.2	
Impala Platinum	814	3.2	
Gold Fields	473	1.8	
Harmony Gold Mining	435	1.7	
Positions less than 1%	905	3.5	
Financials	**4 307**	**16.8**	**20.0**
Sanlam	1 200	4.7	
Standard Bank	1 115	4.3	
Old Mutual	384	1.5	
Investec	307	1.2	
MMI Holdings	280	1.1	
Positions less than 1%	1 021	4.0	
Industrials	**13 426**	**52.2**	**43.2**
British American Tobacco	3 068	11.9	
SABMiller	2 503	9.7	
Remgro	1 862	7.2	
MTN	659	2.6	
Mondi	557	2.2	
Nampak	471	1.8	
Sappi	432	1.7	
Tongaat-Hulett	408	1.6	
Illovo Sugar	303	1.2	
Netcare	297	1.2	
Datatec	295	1.2	
Tiger Brands	268	1.0	
Positions less than 1%	2 303	9.0	
Other securities	**183**	**0.7**	
Money market and call deposits	**518**	**2.0**	
Totals	**25 705**	**100.0**	

NOTE: 12.34% of the Fund is invested in inward listed shares, which are considered foreign investments.
* Including positions in Anglo American Plc stub certificates

Allan Gray Unit Trusts annualised performance in percentage per annum to 30 September 2011

	3 MONTHS (unannualised)
UNIT TRUSTS [1]	
High net equity exposure (100%)	
ALLAN GRAY EQUITY FUND (AGEF)	[3]
FTSE/JSE All Share Index	
ALLAN GRAY-ORBIS GLOBAL EQUITY FEEDER FUND (AGOE)	[3]
FTSE World Index (Rands)	
Medium net equity exposure (40% - 75%)	
ALLAN GRAY BALANCED FUND (AGBF)	[3]
Average of both Prudential Medium Equity category and Prudential Variable Equity category (excl. AGBF)	
ALLAN GRAY-ORBIS GLOBAL FUND OF FUNDS (AGGF)	[3]
60% of the FTSE World Index and 40% of the JP Morgan Government Bond Index Global (Rands)	
Low net equity exposure (20% - 40%)	
ALLAN GRAY STABLE FUND (AGSF) - (NET OF TAX)	[3]
Call deposits from FirstRand Bank Ltd plus two percentage points (Net of tax)	
ALLAN GRAY STABLE FUND (AGSF) - (GROSS OF TAX)	[3]
Call deposits from FirstRand Bank Ltd plus two percentage points (Gross of tax)	
Very low net equity exposure (0% - 20%)	
ALLAN GRAY OPTIMAL FUND (AGOF)	[3]
Daily call rate of FirstRand Bank Ltd	
ALLAN GRAY-ORBIS GLOBAL OPTIMAL FUND OF FUNDS (AGOO)	[3]
Average of US$ Bank deposits and Euro Bank deposits	
No equity exposure	
ALLAN GRAY BOND FUND (AGBD)	[3]
BEASSA All Bond Index (total return)	
ALLAN GRAY MONEY MARKET FUND (AGMF)	[3]
Domestic fixed interest money market unit trust sector (excl. AGMF) [2]	

Total Expense Ratios (TERs)

	Equity Fund	Global Equity Feeder Fund	Balanced Fund	Global Fund of Funds
Performance component	-0.08%	0.51%	-0.09%	0.29%
Fee at benchmark	1.71%	1.49%	1.16%	1.24%
Total fees*	1.63%	2.00%	1.07%	1.53%
Trading costs	0.10%	0.13%	0.09%	0.15%
Other expenses	0.01%	0.05%	0.02%	0.07%
Total Expense Ratio (TER)	1.74%	2.18%	1.18%	1.75%
Annualised fee* rate for latest quarter	2.34%	2.18%	1.25%	1.63%

** Including underlying Orbis Fund fees.*

A Total Expense Ratio (TER) of a portfolio is a measure of the portfolio's assets that were relinquished as a payment of services rendered in the management of the portfolio. The total operating expenses are expressed as a percentage of the average value of the portfolio, calculated for the year to 30 June 2011. Included in the TER is the proportion of costs incurred by the performance component, fee at benchmark and other expenses. These are disclosed separately as percentages of the net asset value. Trading costs (including brokerage, VAT, STT, STRATE, levy and insider trading levy) are included in the TER. A high TER will not necessarily imply a poor return nor does a low TER imply a good return. The current TER cannot be regarded as an indication of future TERs.

Orbis Funds annualised performance in percentage per annum to 30 September 2011

	3 MONTHS (unannualised)
ORBIS FUNDS (RANDS) REGISTERED FOR MARKETING IN SOUTH AFRICA [1, 6]	
ORBIS GLOBAL EQUITY FUND (RANDS)	**-2.0**
FTSE World Index (Rands)	-1.9
ORBIS JAPAN EQUITY (YEN) FUND (RANDS)	**22.7**
Tokyo Stock Price Index (Rands)	12.5
ORBIS ASIA EX-JAPAN EQUITY FUND (RANDS)	**-5.6**
MSCI Asia Ex-Japan (Rands)	-6.3
ORBIS OPTIMAL SA FUND - US$ CLASS (RANDS)	**15.8**
US$ Bank Deposits (Rands)	18.5
ORBIS OPTIMAL SA FUND - EURO CLASS (RANDS)	**8.7**
Euro Bank Deposits (Rands)	10.0

1 YEAR	3 YEARS	5 YEARS	10 YEARS	SINCE INCEPTION	ASSETS UNDER MANAGEMENT (R million)	INCEPTION DATE
6.7	**12.4**	**10.8**	**20.7**	**27.8**	**25 704.9**	**01.10.98**
3.6	10.6	8.8	17.2	17.9		
7.9	**3.4**	**0.7**	**-**	**8.6**	**4 958.0**	**01.04.05**
10.1	0.1	-0.3	-	6.9		
10.4	**11.3**	**10.5**	**17.9**	**19.9**	**44 954.4**	**01.10.99**
5.9	8.7	8.2	14.2	13.5		
16.1	**4.2**	**4.2**	**-**	**7.2**	**6 784.6**	**03.02.04**
15.0	3.6	3.8	-	7.0		
11.1	**8.8**	**9.1**	**12.3**	**13.0**	**27 204.0**	**01.07.00**
5.0	6.4	7.2	7.4	7.5		
11.8	**9.7**	**10.1**	**13.4**	**14.2**	**27 204.0**	**01.07.00**
6.8	8.7	9.7	9.9	10.1		
4.8	**6.5**	**8.0**	**-**	**8.8**	**2 243.9**	**01.10.02**
4.7	6.5	7.6	-	7.5		
15.4	**-**	**-**	**-**	**3.1**	**624.1**	**02.03.10**
16.1	-	-	-	3.9		
7.8	**10.8**	**9.9**	**-**	**9.6**	**432.3**	**01.10.04**
5.9	10.1	9.0	-	9.1		
5.9	**7.9**	**8.9**	**9.0**	**9.0**	**8 577.0**	**03.07.01**
5.7	7.7	8.7	8.9	8.9		

Stable Fund	Optimal Fund	Global Optimal Fund of Funds	Bond Fund	Money Market Fund
0.06%	0.00%	0.00%	0.05%	0.00%
1.15%	1.14%	0.97%	0.29%	0.29%
1.21%	1.14%	0.97%	0.34%	0.29%
0.06%	0.08%	0.17%	0.00%	0.00%
0.02%	0.01%	0.07%	0.04%	0.01%
1.29%	1.23%	1.21%	0.38%	0.30%
1.27%	1.14%	1.01%	0.61%	0.29%

1 YEAR	3 YEARS	5 YEARS	10 YEARS	SINCE INCEPTION	ASSETS UNDER MANAGEMENT (R million)	INCEPTION DATE
7.5	**3.2**	**0.7**	**7.8**	**17.4**	**-**	**01.01.90**
9.4	0.0	-0.4	3.7	11.3		
37.5	**7.6**	**1.4**	**5.2**	**13.8**	**-**	**01.01.98**
17.2	-0.2	-3.8	1.8	5.9		
-3.2	**10.1**	**6.9**	**-**	**12.1**	**-**	**01.01.06**
-1.6	7.9	5.6	-	11.4		
13.9	**2.2**	**3.8**	**-**	**9.5**	**-**	**01.01.05**
15.4	-0.4	2.8	-	8.1		
13.3	**0.9**	**4.8**	**-**	**8.8**	**-**	**01.01.05**
14.4	-1.5	4.2	-	7.7		

Segregated and life pooled portfolios annualised performance in percentage per annum to 30 September 2011

	3 MONTHS (unannualised)
SEGREGATED PORTFOLIOS [5]	
GLOBAL BALANCED COMPOSITE	**4.3**
Mean of Alexander Forbes Global Large Manager Watch [2, 4]	-0.5
DOMESTIC BALANCED COMPOSITE	**1.7**
Mean of Alexander Forbes Domestic Manager Watch [2,7]	-2.1
DOMESTIC EQUITY COMPOSITE	**-0.7**
FTSE/JSE All Share Index	-5.8
GLOBAL BALANCED NAMIBIAN HIGH FOREIGN COMPOSITE	**4.9**
Mean of Alexander Forbes Namibia Average Manager [2]	-0.9
RELATIVE DOMESTIC COMPOSITE	**-3.9**
Weighted average of client specific benchmarks [2]	-5.1
FOREIGN BEST VIEW (RANDS) COMPOSITE [8]	**10.7**
60% of the MSCI and 40% of the JP Morgan Government Bond Index Global (Rands)	7.3
LIFE POOLED PORTFOLIOS	
GLOBAL BALANCED PORTFOLIO	**4.2**
Mean of Alexander Forbes Global Large Manager Watch [7]	-0.5
DOMESTIC BALANCED PORTFOLIO	**1.8**
Mean of Alexander Forbes Domestic Manager Watch [7]	-2.1
DOMESTIC EQUITY PORTFOLIO	**-0.8**
FTSE/JSE All Share Index	-5.8
DOMESTIC ABSOLUTE PORTFOLIO	**4.9**
Mean of Alexander Forbes Domestic Manager Watch [7]	-2.1
DOMESTIC STABLE PORTFOLIO	**2.9**
Alexander Forbes Three-Month Deposit Index plus 2%	1.9
DOMESTIC OPTIMAL PORTFOLIO [1]	**2.5**
Daily Call Rate of Nedcor Bank Limited	1.2
GLOBAL ABSOLUTE PORTFOLIO	**7.7**
Mean of Alexander Forbes Global Large Manager Watch [7]	-0.5
DOMESTIC STABLE MEDICAL SCHEME PORTFOLIO	**3.0**
Consumer Price Index plus 3% p.a. [2]	2.0
GLOBAL STABLE PORTFOLIO	**7.2**
Alexander Forbes Three-Month Deposit Index plus 2%	1.9
RELATIVE DOMESTIC EQUITY PORTFOLIO	**-4.1**
FTSE/JSE CAPI Index	-5.5
MONEY MARKET PORTFOLIO [1]	**1.4**
Alexander Forbes Three-Month Deposit Index	1.3
FOREIGN PORTFOLIO [1]	**10.6**
60% of the MSCI Index and 40% JP Morgan Government Bond Index Global (Rands)	7.3
ORBIS GLOBAL EQUITY PORTFOLIO [1]	**-2.1**
FTSE World Index (Rands)	-1.9
HEDGED DOMESTIC EQUITY PORTFOLIO	**-0.4**
FTSE/JSE All Share Index	-5.8

PERFORMANCE AS CALCULATED BY ALLAN GRAY

1 The fund returns are net of investment management fees
2 The return for the quarter ending 30 September 2011 is an estimate as the relevant survey results have not yet been released
3 Unable to disclose due to ASISA regulations
4 Consulting Actuaries Survey returns used to 31 December 1997. Alexander Forbes Global Large Manager Watch used from 1 January 1998. Alexander Forbes Non-Investable Large Manager Watch used from 1 April 2010
5 The composite assets under management figures shown include the assets invested in the pooled portfolios above where appropriate
6 Amounts invested by the Allan Gray client portfolios in the Orbis funds are included in the assets under management figures in the table above
7 The mean returns of the Alexander Forbes Non-Investable Large Manager Watch used from 1 April 2010
8 The foreign carve out returns of the Global Balanced Composite used from 25.03.96 to 31.08.01. The Foreign Balanced Composite returns are used from 01.09.01

1 YEAR	3 YEARS	5 YEARS	10 YEARS	SINCE INCEPTION	ASSETS UNDER MANAGEMENT (R million)	INCEPTION DATE
11.0	12.2	12.0	18.8	22.9	28 574.7	01.01.78
7.3	10.4	9.7	15.5	17.6		
8.6	13.5	13.6	21.0	23.4	26 135.8	01.01.78
5.6	11.9	11.5	17.5	18.2		
6.5	13.7	13.8	23.9	21.8	46 243.2	01.01.90
3.6	10.6	8.8	17.2	14.4		
11.4	10.7	11.7	18.3	19.7	6 150.4	01.01.94
7.4	9.4	10.5	15.5	14.2		
4.6	12.6	11.0	20.4	20.8	10 102.7	19.04.00
4.1	11.0	9.6	17.0	15.5		
15.4	4.1	3.8	7.8	13.6	8 101.2	23.05.96
14.0	3.5	3.7	5.1	10.1		
11.3	12.3	12.1	18.8	20.4	17 714.9	01.09.00
7.3	10.4	9.7	15.5	14.6		
9.0	13.7	13.7	21.4	21.0	6 610.1	01.09.01
5.6	11.9	11.5	17.5	16.7		
6.9	13.9	13.7	24.1	24.1	6 292.2	01.02.01
3.6	10.6	8.8	17.2	15.1		
10.1	14.6	16.2	23.9	24.1	1 078.7	06.07.01
5.6	11.9	11.5	17.5	16.3		
8.0	11.4	12.2	-	15.9	1 818.9	01.12.01
7.7	9.6	10.6	-	11.0		
5.7	7.6	9.0	-	9.2	498.5	04.12.02
4.9	6.7	7.9	-	7.7		
12.9	13.2	14.9	-	19.7	2 138.8	01.03.04
7.3	10.4	9.7	-	16.0		
8.1	11.1	12.0	-	14.5	1 401.6	01.05.04
8.6	7.7	9.9	-	9.1		
12.2	10.0	11.0	-	14.6	2 496.4	15.07.04
7.7	9.6	10.6	-	10.2		
4.8	12.3	10.9	-	23.2	428.0	05.05.03
3.9	11.1	9.5	-	21.5		
6.2	8.2	9.0	9.3	9.4	331.7	21.09.00
5.6	7.4	8.5	8.9	9.0		
15.3	4.1	3.8	-	4.6	2 109.2	23.01.02
14.0	3.5	3.7	-	2.4		
7.3	3.3	0.8	-	8.8	3 855.3	18.05.04
9.4	0.0	-0.4	-	7.2		
6.7	13.4	-	-	8.0	1 038.9	01.06.08
3.6	10.6	-	-	0.8		

Unit trusts	A unit trust is a savings vehicle for investors who want to grow their money and may want to access it before they retire. Unit trusts allow investors to pool their money with other investors who have similar investment objectives. Unit trusts are also known as 'portfolios of collective investment schemes' or 'funds'. Allan Gray has nine funds in its stable: Equity, Balanced, Stable, Optimal, Money Market, Bond, Global Equity Feeder, Global Fund of Funds and Global Optimal Fund of Funds.
Retirement Annuity*	The Allan Gray Retirement Annuity Fund (RA) is a savings vehicle for investors looking for a flexible, tax-efficient way to save for retirement. Investors can only access their money when they retire. Individually owned RAs can be managed on a group basis, offering employers a flexible solution to the challenge of retirement funding for their staff.
Preservation funds*	The Allan Gray Pension Preservation and Provident Preservation funds are savings vehicles for investors looking for a tax-efficient way to preserve existing retirement benefits when they leave a pension or provident fund, either as a result of a change in employment (e.g. retrenchment or resignation), or when they transfer from another preservation fund.
Endowment*	The Allan Gray Endowment Policy is a savings policy for investors who want a tax-efficient way to save, and wish to create liquidity in their estate.
Living Annuity*	The Allan Gray Living Annuity gives investors flexibility, within certain regulatory limits, to select an annuity best suited to their income needs after retirement. A living annuity provides investors with a regular income which is not guaranteed, and which is funded by growth on capital and income from interest and dividends.
Offshore funds	Through our partnership with Orbis we offer you a cost-effective way to diversify your portfolio by investing offshore. There are two options for investing offshore through Allan Gray: invest in rand-denominated offshore funds without the need to use your offshore investment allowance, or use your offshore investment allowance to invest in foreign funds.
Platform – local and offshore	Our investment platform provides you with access to all of our products, as well as a focused range of unit trusts from other fund providers. The platform enables you to buy, sell and switch – usually at no charge – between the funds as your needs and objectives change. South African investors who wish to diversify their portfolios can also access funds from certain other offshore fund providers via the same platform.
Life pooled portfolios	The minimum investment per client is R20 million. Mandates include risk-profiled pooled portfolios: Stable Portfolio, Balanced Portfolio and Absolute Portfolio; asset class pooled portfolios: Money Market, Equity and Foreign, and finally an Optimal Portfolio. Institutional investments are currently restricted to existing investors only (except for foreign mandates).
Segregated portfolios	The minimum portfolio size is R500 million. Mandates are of a balanced or asset class specific nature. Portfolios can be managed on an absolute or relative risk basis. Institutional investments are currently restricted to existing investors only (except for foreign mandates).
Botswana	Allan Gray Botswana manages institutional portfolios on a segregated basis, and offers our range of nine South African unit trusts to individual investors.
Namibia	Allan Gray Namibia manages institutional portfolios on a segregated basis and the Allan Gray Namibia Investment Trust provides investment management for Namibian retirement funds in a pooled vehicle.
Swaziland	Allan Gray Swaziland manages institutional portfolios on a segregated basis.
Allan Gray Orbis Foundation	Allan Gray Orbis Foundation is a non-profit organisation that was established in 2005 as an education and development catalyst. It seeks to foster a next generation of high-impact leaders and entrepreneurs for the ultimate purpose of increased job creation in Southern Africa. The Foundation focuses on educational and experiential methods at the secondary and tertiary levels to realise the potential of bright young minds. Through its highly researched learning programmes, it intends equipping talented young individuals with the skills, attitudes and motivation to have significant future impact.
E^2	E^2 stands for 'excellence in entrepreneurship' and as a long-term capital fund its purpose is to provide substantial financing to entrepreneurs who are graduates of the Allan Gray Fellowship Programme. In addition, E^2 provides financing for social entrepreneurs who demonstrate exceptional leadership and creative initiative in the not-for-profit sectors.

* This product has unit trusts as its underlying investment option.

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